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191207Z Dec 03

UNCLAS ZAGREB 002654

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VIENNA FOR FAS

E.O. 12958: N/A

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SUBJECT: CROATIAN TRADE SPAT WITH HUNGARY

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Summary

1. (U) Recent headlines announcing the death of the Hungarian-Croatian Free Trade Agreement are premature, but not by much. Hungary's decision to raise tariffs on selected Croatian products may be a last gasp of exasperation before Hungary apparently loses its ability to single out countries for special treatment upon its entry into the EU. While trade negotiators and veterinarians will hopefully find a compromise over the meat certification issue that has provoked this mini-trade war, the Minister of Agriculture has warned that Hungary has more to lose than Croatia should Croatia decide to reciprocate. End Summary.

Another case of BSE-fallout?

2. (U) The trade tensions that ultimately resulted in Hungary raising its tariffs on December 9 on 15 items -- mainly processed food -- arose out of a Croatian decision in May to ban all meat products from livestock fed with bone meal, whether they be ruminants (such as cows) or non-ruminants (such as chickens and pigs). The U.S. and other countries argue that there is little risk in using bone meal to feed animals that do not contract BSE-like diseases. Croatia itself banned the practice of using bone meal feed for all livestock three years ago, whereas Hungary (like the U.S.) at first only banned the use of bone meal for ruminants when BSE first broke out in Europe.

3. (SBU) According to our contacts at the Ministry of Agriculture, after originally protesting the Croatian ban, Hungary adopted a similar measure this past summer. However, it gave its agricultural producers 60 days to implement the measure, presumably in order to give them time to use up existing bone meal stocks and to find substitutes. Croatia duly lifted the ban on products from Hungary, as long as they were "bone meal free."

4. (SBU) While Hungary wanted Croatia to accept meat products from a list of about 200 Hungarian companies that Hungarian veterinarians were willing to certify as bone-meal-free (companies which had adopted a "voluntary ban"), Croatia demanded testing and traceability. The Croatians wanted to do random checks of a number of these "bone meal free" meat plants. This apparently was the final straw for the Hungarians

5. (U) On December 9, Hungary suspended FTA rates for 15 Croatian products. In effect, the low FTA-rates reverted back to MFN rates. This can be a high barrier -- in one example, the tariff on dried soups jumped from four percent to 32 percent. The Croatians claim this was done without prenotification and in violation of the provisions of the FTA, which calls for consultations if "interests" are damaged and before any privileges are withdrawn, though they admit the Hungarians had indicated there would be consequences if Croatia continued to block pork imports once Hungary had a comprehensive ban in place. The Croatians claim they learned of the tariff changes the day they were implemented. While exports to Hungary only make up less than three percent of Croatian exports, the tariffs hit a few companies, most significantly Podravka, hard. While Prime Minister Racan has spoken of how a trade war would hurt everyone, Minister of Agriculture Pankretic has pointedly reminded the Hungarians that they have more to lose than Croatia. In the first 10 months of 2003, Croatia exported only \$67 million of goods to Hungary, but imported \$350 million from that country.

Or Croatian Protectionism?

6. (SBU) While Croatia is probably motivated partly by

protectionism, the picture is a bit more complicated than that. While Hungary is reportedly facing a surplus of pork and depressed prices, Croatia is actually in a shortage situation, especially for higher quality pork, and has been importing pork for a number of years. Shortages have been exacerbated by foot-and-mouth disease in some of its source

countries. Nevertheless, Croatian pork producers have tried to urge the government to "encourage" meat processors to use lower quality, higher priced Croatian pork. They can argue that with the total bone meal ban they have lived with for three years, they face higher costs and need a level playing field. This justification will be eliminated in a few months time, when the generation of Hungarian pigs old enough for slaughter will all be from the post-ban era.

17. (SBU) Additionally, Croatian officials are extremely cautious -- even over-cautious -- in the face of public concern about BSE. Bureaucratic pride may have played a role as well -- the Hungarian veterinarians did not like having their certificates questioned, while the Croatians did not like being told they did not have the right to verify these certificates.

18. (SBU) While the FTA will lapse upon Hungary's entry into the EU in May 2004, Croatia will then face in the Hungarian market the generally low preferential tariffs it enjoys with the EU. Our contacts tell us that Hungary should lose its ability to single out countries for punishment (the possibility of misusing sanitary measures will remain, no doubt). However, May is a long way off for the companies that are negatively affected, and the GOC hopes to negotiate a solution. If not, Croatia may well retaliate.

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